

Adding Value Where Value Counts

By GEOFFREY C. LOYND

If I were asked for a one-sentence definition of what we do as fee-only financial advisors, I would say we seek to add the most value we can to our clients' financial situation, whichever way we can.

Given this all-inclusive starting point, I am not surprised by the diversity of what advisors do. I am,

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nevertheless, a bit perplexed by the varying degrees of emphasis that is put on investment return. I've often run across financial advisors who take quite a casual approach to portfolio management, viewing it as simply one of a number of areas they address. They take the position that they are not in the investment-return business, but rather in the relationship-building business. It seems to me, however, that if we are to strive to be "value adders," our greatest opportunity lies in the area of investment return.

There are, broadly speaking, three ways we can provide value for our clients. One, we can produce financial projections that will, we hope, assist them in reaching their financial goals. Two, we can analyze and recommend docu-

ments and products that are most appropriate for individual circumstances. Three, we can provide investment advice and/or management appropriate to their needs, circumstances, and risk profiles.

Anyone who has analyzed them closely understands the limitations of financial projections. The fact is, the accuracy--and value--of any long-term financial projection lies somewhere between "the best we can do" and "better than nothing." To see why, just look at what happens to the terminal values of projections when a critical assumption such as inflation is changed by a few percentage points. (The average annual increase in the Consumer Price Index from 1952 to 1967 was 1.6 percent; from 1968 through 1981 it was 7.6 percent.)

Alternatively, you can read about Lynn Hopewell's IAFP convention presentation on the "Monte Carlo Solution" for projection inaccuracies, as reported by Bob Veres in *Dow Jones Investment Advisor*¹. Veres writes that "in about 60 minutes... Hopewell rendered all-but-obsolete the very core of financial planning analysis: the traditional retirement plan." Yet some advisors view this document as the core value they offer.

In talking with my clients, I make the analogy of a mariner who takes daily sextant readings, knowing full well that tomorrow's reading may prove today's far from exact. It is prudent to make the best use we can of available tools, even if they are inexact. However, a satellite global positioning system to make our financial forecasts does not exist. It is imprudent, indeed dangerous, to fool

ourselves and our clients into thinking we have one.

One of my more pleasant experiences was obtaining almost \$50,000 in Social Security benefits that the government repeatedly told my clients, a semi-retired couple with about \$200,000 in assets, they were not eligible for. And, to be sure, there are many instances where we can provide our clients with service of significant value by, for example, weeding out inappropriate financial products and making other adjustments in their financial situations. The reality, nonetheless, is that as often as not added value from this type of work is less consequential than increasing the value of a client's portfolio.

I hear a lot about the service we provide as "financial psychiatrists." Money issues do have many psychological underpinnings, and advisors who fail to understand this probably have not, and will not, work with

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many clients. However, analogies to other professionals should be considered when evaluating the importance and value of this role.

If I am to have an operation, decision-making and emotional preparation is easier if my physician is skilled in bedside manner. But what I really care about is how well the operation goes.

We all know the effect of compounded investment return. The following is a simple example to keep in mind:

A 40-year-old couple brings a \$100,000 retirement portfolio to an advisor. By age 75, the portfolio will grow to \$768,609, \$1,478,534, and \$2,810,244, respectively, at 6 percent, 8 percent, and 10 percent average annual return.

Increasing the return on investment, even if only by a small amount, is one of the few opportunities a financial advisor has to make million-dollar differences in the lives of people of otherwise modest means. Yet too many advisors' investment approach doesn't go much beyond "mutual funds are good investment vehicles and I know a few good names."

Notwithstanding the many studies that demonstrate the dominant role played by asset allocation, we still keep hearing the cliché, "Take your age and sub-

tract it from 100..." According to this rule of thumb, 50-year-olds should have fully one-half of their assets in bonds. Whoever came up with that notion should be sentenced to a life term proof-reading municipal bond offerings. I'm positive their clients' portfolios are on the bottom end of the spectrum.

While we should not all be trying to become the next Peter Lynch, we should direct our efforts toward those areas that represent the most potential for adding value. What percent of advisors fully understands the argument over whether

time reduces or increases investment risk?² Or whether international diversification may actually increase risk, and why small-cap international stocks provide better diversification than their large-cap counterparts?³ Staying on the cutting edge of financial research and product availability is a major part of the ongoing value we provide for our clients. This may not guarantee solid returns, but not doing so will almost certainly lead to poor performance.

To be thorough, a personal financial advisor must address numerous areas of potential value.

However, advisors who view portfolio management as an also-ran fail to recognize that, in most instances, this is the major area for adding value to clients' finances (most exceptions probably are in the area of tax savings, particularly estate tax planning). As fee-only advisors, most of us established our practices with the idea of doing good while doing well.

Personal financial advisors who do not direct substantial effort toward obtaining every possible percentage of investment return, taking risk profiles into account, may be doing well, but they are

not doing as much good as they could be. ■

¹ Robert N. Veres, "The Monte Carlo Solution," *Dow Jones Investment Advisor*, May 1996, p. 3.

² Richard W. McEnally, "Time Diversification: Surest Route to Lower Risk?," *The Journal of Portfolio Management*, Summer 1985.

³ Rex A. Siquefield, "Where Are the Gains from International Diversification," *Financial Analysts Journal*, January-February 1996, pp. 8-14.

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